Livestock and Dairy Outlook – The Climb Continues for Most

Stephen R. Koontz[1], James G. Robb[2], Erica L. Rosa-Sanko[3], and Katelyn E. McCullock[4]

Agricultural producers – and the agricultural economy as a whole – do not much talk about recession. The recession is clearly over for agriculture. But agriculture would do well to remember the struggles the rest of the economy faces. The rest of the economy faces persistent unemployment, problems with real estate debt, cautious lending, and much talk about austerity. The recovery can only be described as anemic. With that said, many of our livestock price forecasts over the recent years have been rather wrong – our forecasts were largely too low and actual prices seen for livestock products were much higher than we anticipated. For cattle and hogs, the stronger than anticipated prices in 2011 were largely due to surging exports, both in tonnage and especially in value. What about 2012 and 2013?

Cattle Situation and Outlook

In 2011, cattle and beef markets continued the rebound started in 2010 from the very poor conditions of 2009. Cattle prices roared higher in 2010 and continued the tear in 2011. Beef production was higher in 2010 than in 2009 and decreased only modestly in 2011. How are higher production and higher prices possible? The answer is strong demand, mostly exports. Also, much of the year-on-year increase in beef production was driven by drought induced liquidation of breeding stock. Domestic consumption was actually lower these two years because of strong exports. But regardless, even accounting for the reduced consumption, domestic demand also showed some improvement. This story is important to tell and remember given all the focus of the drought in the southern plains. An enormous supply contraction is likely occurring at the same time demand is strong. The outlook for 2012 and 2013 is for continued strong cattle and beef prices. How high? It will be record high.

Prices continued to improve all through 2011. Fed cattle prices were 23% higher in the first quarter, 17% higher in the second quarter, 20% higher in the third, and 22% higher in the fourth quarter. Compared to the prior year, fed cattle prices averaged $114.74 per cwt, which was up 20.3%. And it is important to remember that prices in 2010 averaged 14.6% higher than 2009. Better prices were not limited to fed cattle. In 2011, feeder cattle (700-to-800 pounds) prices averaged $135 per cwt and calf (500-to-600 pounds) prices averaged just over $148 per cwt. Fed cattle, feeder cattle and calf prices moved to some of the highest prices ever seen for those animals at the end of 2011. Profits to cattle feeders were abysmal as this industry was paying for these high priced feeder animals and also very expensive corn. In contrast, cow-calf operations made excellent profits from calf marketings.

[1] Agricultural Economist and Extension Specialist, Colorado State University
[2] Director, Livestock Marketing Information Center
[3] Agricultural Economist, Livestock Marketing Information Center
[4] Dairy and Forage Economist, Livestock Marketing Information Center

As we have discussed for years, domestic and international consumer demand is critical for the for strong beef and cattle prices. The beef demand index made solid year over increases in each quarter of 2011. And these improvements began with the fourth quarter of 2010. Examining beef cut prices reveals the form of the improvement was for end meats – the chuck and the round – and for hamburger. Demand for middle meats was lackluster at best. Further, beef exports made solid expansions in 2011 – and this is on top of a very strong 2010. Export tonnage recovered to pre-BSE levels and it is interesting to ponder the question of future expansion: do large percentage increases continue or are the increases more modest? There is also an interesting question related to the U.S. consumer: what is the impact on beef demand of a solid economic recovery returning the consumer's interest in middle meats?

The other story that has been underlying the cattle market for years also continues. Liquidation of the beef herd persists as do high feed costs. These two supply impacting factors continue to be an issue and likely will make the coming herd expansion have a more dramatic market price impact. The slaughter data from 2011 was clear, beef producers continued to liquidate beef cow herds. And the January 1, 2012 USDA Cattle report confirmed that the beef cow inventory was down 3% from 2011 and the calf crop was 1% lower. Cattle producers were clearly responding to historical drought conditions in the southern U.S. But interestingly, there are finally initial signs of herd stabilization and movement toward expansion. Producers increased the number heifers held as beef cow replacements by 1%. For the past 5 years, producers have marketed year over a larger percentage of heifers into the meat system. Cow-calf operations in almost every state in the nation held heifers to place into the breeding herd. The exceptions were states in the southern plains and some Midwestern states. But, this is not yet herd rebuilding; it's only slowing the rate of breeding herd decline. That is, another year-on-year increase in heifer retention will be required before we can clearly infer any beef cowherd expansion.

This additional heifer hold-back, after years of liquidation and resulting in tight supplies, will only exacerbate the tight supplies and drive calf prices to record highs. We see this occurring in earnest the fall of 2012 and into 2013 – provided pasture conditions improve. Returns to cow-calf producers have markedly increased the past two years and are forecast to be better than $150 per head for the next two. Tight animal supplies are good news for Colorado cow-calf producers but are not good news for segments of the cattle industry that are important to Colorado. Smaller supplies will negatively impact cattle feeders and meatpackers.

The corn market is also revealing what appears to be a normal trading range and it is higher that what the livestock industry is used to. In 2011, there was much uncertainty about the crop in the field over the summer and on the heels of the prior year's persistent revisions down to USDA production numbers. There were two strong years of corn demand and production well below usage. Thus, through the summer of 2011 the corn market did what grain markets do when faced with uncertainty and a potentially short corp. Prices interested across the summer as much of the crop was purchased or contracted for. Then corn prices softened as the U.S. entered harvest. The bad news for the livestock industry is that this high priced crop is in the feed bunk and will be fed until the next crop is harvested. And there is emerging uncertainty with that 2012 crop. The normal La Nina pattern that has created a drought stricken southern U.S. is also failing now to provide the normal wet weather seen in the northern U.S. The La Nina is clearly moderating, providing some rain but not much relief to the southern U.S. What does remain is uncertainty about the soil moisture and outlook for next year's corn crop.

And before we leave feedstuffs, we do need to mention the forage market. Drought in the southern plains substantially increased the demand for hay. Hay stocks are very tight in the southern U.S. and tighten nationwide. Further, the strong hay price has pulled acreage from forage into corn production. Harvested hay acres were down 7% in 2011, much of which was due to drought but not all. Forage prices will likely moderate some in 2012 but will remain high by historical standards.

Calf prices will likely average over $160 per cwt during 2012. Prices should average $153-163 in the fourth quarter. Calf prices could be even higher if feedstuff costs decrease and cattle feeding returns improve. Calf prices are forecast to average even higher in 2013. Feeder cattle prices in 2012 are expected to average $145-150 in 2012. Feeder cattle prices are forecast to strengthen in 2013. Annual average calf and feeder cattle prices will to move to record setting new high levels for at least the next two years. But extent will depend on domestic and international demand and feedstuff prices.

U.S. beef production for 2012 is forecasted to be down 3.9% and down 2.8% in 2013. The net impact of trade likely will cause U.S. per capita consumption to be 3.5% lower in 2012 and 3.4% lower in 2013. As a minimum, we expect the high beef prices to restrict the rate of growth in exports in 2012. Still, reduced domestic supplies will result in record high retail prices for beef in the coming years. Expect that to be a major news story. And expect that to not be well received if the economic recovery is not substantive. We look for fed cattle prices to average $123-127 per cwt in 2012. Fed cattle prices will see seasonal strength in the second quarter and only have to potential go lower with the seasonal increase in production in the third quarter. Fed cattle prices are forecasted to average $129-133 for 2013 with the potential for $135 fed cattle in the second and fourth quarters.

Dairy Situation and Outlook

2011 saw some robust improvements in product prices for dairy producers. But it also saw the dairy industry return to herd building. The industry simply did this too early. One more year – or even two or three quarters – of reducing animal numbers would help the outlook for 2012 and 2013. As is, we see profitability trouble through 2012 and a race to see if exports can expand fast enough so that news about the dairy industry does not focus again on financial problems.

2007 and 2008 saw a tremendous expansion in dairy exports. Milk prices over this time period were very high and dairy profitability was good even with the high feed prices. The dairy industry then did the predictable: it expanded. Dairy cow numbers were increased. This is important because the persistent trends in the dairy industry are decreasing cow numbers and increased productivity per cow. The two in combination typically result in year over increases total milk production. Total production increased sharply when dairy cow numbers were actually expanded, creating a large supply of available milk. The market downturn was made worse by the domestic and world economic recession starting at the end of 2008 and persisting through 2009 into 2010. Exports contracted sharply and domestic demand was flat. Milk prices fell 35% to an average Class III price of $11.36 per cwt. in 2009.

We anticipated that the dairy industry would contract sharply in 2009 and 2010 and that prices would improve following this. There has also been substantial financial reorganization in the dairy industry but fewer numbers of cows have been removed from producing herds than such news would suggest. In fact, the cows that were slaughtered were very clearly poor milk producers. 2010 saw a 1% reduction in cow numbers and a 2.8% increase in productivity per cow. This increase in productivity is one of the highest in recent history. Thus, milk production was up 1.8%. 2011 saw milk producers increase cow numbers 0.9% and have production per cow increase also 0.9% so that total production was up 1.8%. The average Class III milk price in 2011 was $18.37 per cwt.

The average Class III milk price climbed above $20 and $18 per cwt in the third and fourth quarters of 2011 and this was with a 1.3% and 2.3% increase in production for those quarters. Commercial disappearance of milk was up 0.2% and is expected to be up 3% for those quarters so it appears that domestic demand has improved. Dairy exports also had supportive rolls in milk price, showing large year over year gains in quarters one and two, and more moderate gains in the third and fourth quarters. This is good news but profitability at these price levels is still modest. A small amount of continued liquidation would have substantially improved prices. But the dairy industry appears reluctant.

Dairy cow numbers are forecast to be down 0.2% in 2012. Production per cow is forecast to increase 0.8% so total milk production will be up 0.6% and commercial disappearance will be up 1.6%. If this occurs, then Class III milk price will decrease 5% and will be $16.95-$17.95 per cwt for 2012. Total milk production is forecast to increase 1.0% in 2013, with exports commercial disappearance will increase 0.8% and Class III milk will be $18.85-$20.35 per cwt in 2013. Again, while these are reasonably strong milk prices the profitability is quite modest given the high feed grain and forages costs. Dairy exports will continue to support key product prices, but growth in export markets may be a limited. The question that is unanswered for us is what is the financial health of the dairy industry and what is the willingness of lenders to extend credit when so much risk is present and the promise of profitability is not strong.

The real positive news for Colorado remains that the new cheese plant in Greeley will push into substantial operations in 2012 and will press for running at full capacity in 2013. We remain guardedly optimistic about this for the Colorado dairy industry. This new market will benefit Colorado but the dairy industry has shown an unwillingness to greatly expand production in the face of feed price risk, and uncertain credit availability, which could limit their abilities to capitalize on opportunities.

Hog Situation and Outlook

Like the dairy industry, the pork industry was glad to see 2009 over. It reduced animal numbers substantially in 2009, and unlike the dairy industry, continued to shrink the herd size through 2010 and the first quarter of 2011. Because of this the hog industry was set up for a stronger recovery than the dairy industry. And this has come to pass. International trade has been strong, as has domestic demand. And the other norm is very high feed costs. So what is in store for the hog market in 2012 and 2013?

The major drivers of hog market changes the past few years have been increasing exports, feed costs, and record growth in sow productivity. The pork industry has exported its way out of much trouble that could have resulted in very low prices and has quickly changed production in the face of high feed costs.

The industry saw two years expansion in 2007 and 2008, followed by two years of contraction in 2009 and 2010. Of course the contraction that began in 2009 was driven by record high feedstuff prices, and demand and price collapses. But much of the industry expected losses in 2009. We expected to see expansion in 2011 and modest expansion with the caution in the lending industry. Modest growth did occur but that was driven by record sow productivity with pigs per litter an average of 2% higher in 2011 than in 2010. This trend is expected to continue and will drive most of the growth in pig numbers during in the next two years.

The hog industry reduced numbers the first quarter of 2011 but increased slaughter weights 2.3% in the face of the 19% improvement in price that quarter. The story of increasing production, decreasing domestic per capita supplies due to record large exports, and increases hog prices is the story for 2011. Animal numbers changed between a decreasing 0.5% to an increasing 1.6% for the quarters of the year. Carcass weights were between a smaller 0.2% and a larger 2.3%. And production was between 1.0% to 2.0% higher year-over for each quarter. However, consumption was 2.7% to 6.4% lower year-over for each quarter. As a consequence, hog prices were 19% higher in the first quarter, 16% higher in the second quarter, 19% higher in the third, and 26% higher in the fourth quarter. Compared to the prior year, hog prices averaged $86.40 per cwt (National Weighted Average Base Price), which was up 19.8%. It is important to remember that prices in 2010 averaged 26.8% higher than 2009. Prices have clearly improved. International demand has clearly improved with 2011 pork exports more than 20% larger than in 2010. And prices have clearly improved more than would be suggested by the reduced per capita supplies available to U.S. consumers, the result of international demand doing much of the work in the pork market.

Expectations are for the hog herd to modestly expand for 2012 and expand again for 2013. Again, most of the growth will be from continued gains in pigs per litter versus expansion of the sow herd. Domestic demand will continue to be a concern while international demand will remain rather supportive of hog prices. High feed costs will remain a concern with volatility expected to continue in 2012 and 2013. Forecasts for 2012 indicate that hog slaughter will be 0.5% below to 2.7% above prior year's quarters with an annual expansion of 1.1%. Market hog carcass weights are expected to increase modestly – increasing 0.1% in 2012 and 0.3% in 2013. The market will see U.S. pork production increase 1.3% in 2012 and increase 2.2% in 2013. With increases in exports then the available supply per person in the U.S. is expected to decline 0.2% in 2012 but increase 1.8% in 2013.

Hog prices are anticipated to increase in 2012 and 2013 as production increases but as exports reduce the pork offered to U.S. consumers by more than that amount. Market hog prices are forecasted to be $83-88 per cwt on a carcass basis in the first quarter of 2012, $89-95 during the second quarter, $91-97 during the third quarter, and $82-89 in the fourth, with an annual average of $86-92. Market hog base prices for 2013 are expected to average $87-94 per cwt.

International demand and strength of trade has clearly revealed its hand in recent years. Pork production can expand 1.4% but the consumption by U.S. consumers is down about 4% and hog prices are up close to 20%. The wild card remains feed costs. Corn prices have climbed to almost $8 per bushel in mid-to-late 2011. And even with excellent hog prices, hog producer margins will be squeezed with these feed costs. 2011 offered producers the opportunity of hedge feed costs at much lower levels but what is the strategy going forward? The 2012 corn crop has spent much of the contract life above $5.50 per bushel. Will there be opportunities for lower price feed this year?

Lamb Situation and Outlook

We were very impressed by the increases in slaughter lamb prices that we saw in 2010. The percent increases in 2011 were almost double. Slaughter lamb prices increased all four quarters of 2011, relative to the same quarter the prior year, that the national average price in 2011 was 42.9% higher than 2010. And 2010 was 24.5% higher than 2009. The story is the same for feeder lamb prices with the annual average in 2011 being 51.5% higher than that in 2010. This is a phenomenal price increase. Lambs have doubled in price in three years. Some of which is due to declining supplies and some from improving demand. These price levels have helped improve profitability in the lamb industry offsetting some of the higher feedstuff prices and will be good for the longer term health of the western lamb raising industry and the Colorado lamb feeders.

For 2011, slaughter lamb prices increased 54% in the first quarter, increased 51% in the second quarter, 47% in the third quarter, and 25% in the fourth quarter compared to the same time periods in 2010. Fed lamb carcass prices averaged about $355 per cwt in 2011. Feeder lamb prices received by ranchers averaged about $219 per cwt. These are phenomenal improvements and incredible prices. The next important question for Colorado and other lamb producers is, was the improvement all due to less supply or is there some evidence of increasing demand for lamb? That story takes some additional details.

Total fed lamb production was down 9.2% for the year. There were 12.0% fewer slaughter lambs and carcass weights were 3.3% heavier due to favorable feeding conditions in 2011. The largest decreases in production were in the first, fourth, and third quarters. There was a very slight seasonal increase in production in the second quarter. The supply of feeder lambs has continued to tighten as the result of a smaller national flock and continued growth in the non-traditional market (which account for about a quarter of feeder lambs marketed in the U.S.). In addition, imports of lamb have also moderated which has further reduced the available supply of lamb product in the U.S. In 2011 imports of lamb were down about 2% however imports of mutton were up 30%. These are two separate products that serve different consumer markets. Per capita consumption of lamb was down 3.5% revealing a tight supply of available lamb due to declines in both production and imports. The largest decrease in available supply of lamb per person was in the third quarter, with declines in the fourth quarter as well, but available supplies increased in the first and second quarters.

So the answer to the demand question is that the price improvements through the year are much larger than what should have been observed given the declines in production and the available supply of lambs. Like the other red meat industries, demand is clearly improving for lamb. And if the demand improvements persist then we expect continued strong prices through 2012 and 2013.

We had been expecting increased domestic production over the past years because of the good prices. Again, there was no price drop even during 2009. But the flock expansion did not occur on a national basis 2011 due to severe drought in the southern plains and continued predator losses in the mountain west regions, as well as high feed and forage prices. And now we are seeing improved demand both in the traditional and non-traditional markets. This will put additional money in lamb feeder and lamb growers' pockets, but margins will continued to be pressured with historically higher feed prices.

U.S. lamb production is expected to decrease substantially for 2012 and 2013 and prices for fed and feeder lambs are expected to hold their current ground. Forecasts suggest a 7.4% decrease in production in 2012 and a 3.7% decrease in 2013. Lamb and mutton imports are expected to increase modestly in 2012 and 2013 but will not be enough to offset most of the domestic production decrease. If both the domestic and import scenarios occur then fed lamb prices could average $370-380 per cwt of carcass in 2012 and $375-385 per cwt of carcass in 2013.

Since 2010, we had been saying that it will be interesting to watch and see if the demand increases invigorate the industry. There have been substantial improvements in consumer demand, possibly from the food media attention and also from non-traditional and ethnic market consumers. Industry efforts to grow the national flock are underway and it will be interesting to see how producers respond in the coming year.